



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
March 27, 2000

OFFICE OF
CHIEF COUNSEL

Number: **INFO 2000-0017**

Release Date: 6/30/2000

UIL: 163.06-00; 461.08-02

The Honorable Frank R. Wolf
Member, United States House of Representatives
13873 Park Center Road
Suite 130
Herndon, VA 20171

Attention: Sharon Snyder

Dear Congressman Wolf:

I am responding to your letter dated February 29, 2000, addressed to Mr. Floyd Williams, National Director for Legislative Affairs of the Internal Revenue Service (IRS). Your letter refers to an inquiry made by one of your constituents, [REDACTED], regarding the deductibility of home mortgage interest. [REDACTED] is concerned about a provision in the Internal Revenue Code that limits the amount of home mortgage interest that can be deducted by a taxpayer in a particular taxable year. In his inquiry, [REDACTED] explains that he paid more than [REDACTED] months of home mortgage interest in 1999, but received a Form 1098 from his lender reflecting only [REDACTED] months of interest. [REDACTED] was referred to IRS Publication 17, Your Federal Income Tax, as authority for the limitation on the amount of home mortgage interest deductible in a taxable year. [REDACTED] asks whether this information is accurate and what is the rationale for such limitation.

Under § 163(h)(3), individual taxpayers are generally permitted to deduct home mortgage interest that is paid or accrued during the taxable year. However, § 461 provides the rules for when deductions, including the deduction for home mortgage interest, must be taken into account for federal income tax purposes. Under § 461(a), the amount of any deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(g)(1) specifically addresses the proper year for deducting prepaid interest. Publication 17, which [REDACTED] cites in his inquiry, paraphrases the rule of § 461(g)(1). The publication states that, if a taxpayer pays interest in advance for a period that goes beyond the end of the tax year, the taxpayer must spread this interest over the tax years to which it applies. The taxpayer can deduct in each year only the interest that qualifies as home mortgage interest for that year.

Section 461(g)(1) expressly provides:

If the taxable income of the taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the secretary, is properly allocable to any period –

(A) with respect to which the interest represents a charge for the use or forbearance of money, and

(B) which is after the close of the taxable year in which paid,

shall be charged to a capital account and shall be treated as paid in the period in which so allocable.

Accordingly, under these provisions, a taxpayer is generally entitled to deduct his or her home mortgage interest. The provisions of § 461(g)(1) merely allocate the taxpayer's interest deductions to the taxable years to which the interest relates. Thus, for 1999, a taxpayer may only deduct interest attributable to the period of January 1, 1999, through and including December 31, 1999. If a taxpayer prepaid interest that was attributable to periods beyond December 31, 1999, even if that amount was included on the taxpayer's 1999 Form 1098, that amount is not deductible in the taxpayer's 1999 taxable year. Rather, that amount generally will be deductible in the taxpayer's 2000 taxable year.

In his inquiry, [REDACTED] also expressed concern about the rationale for this treatment of prepaid interest. Section 461(g)(1) was enacted as part of the Tax Reform Act of 1976, H.R. 10612, 94th Cong., 2d Sess. (1976). In enacting this provision, the Congress sought to eliminate tax shelters stemming from the use of deductions for prepaid interest. See H.R. Rep. No. 94-658, 94th Cong., 1st Sess., at 98-99 (1975). In addition, the Congress sought to clarify uncertainty in the prior law regarding the deductibility of prepaid interest by cash method taxpayers. See H.R. Rep. No 94-658, at 99.

I hope this information is helpful to you and your constituent. For your information, I have included a copy of the relevant section of Publication 17, Your Federal Income Tax. I have also included Publication 936, Home Mortgage Interest, which further explains and clarifies the rules for deducting home mortgage interest.

If I could be of further assistance, please contact me at (202) 622-4800 or Nicole Francis, of my office, at (202) 622-4950.

Sincerely,

Heather C. Maloy
Acting Assistant Chief Counsel
(Income Tax and Accounting)

Enclosures (2)